BRIEF IN SUPPORT OF PETITION OF STANLEY FIELD FOR A WRIT OF CERTIORARI.

This petitioner, Field, stands before the Court on an entirely different basis from any other party. He is a defendant in the instant case only. His connection with the company here involved, Corporation Securities Co. of Chicago, was slight. He did not participate in the company's organization and had no association with or knowledge of its affairs prior to his election to the board of directors in June, 1930. He was never an officer or member of its executive committee, and he had no personal transactions with the company of any character at any time.

Even this connection, slight as it was, was limited to the company here involved, Corporation Securities Co. of Chicago, and did not extend to Insull Utilities Investments, Inc., the company involved in *Aiken, et al.* v. *Insull, et al.* The petitioner never had any connection as officer, director, stockholder, security holder, creditor, or otherwise, with that company. Wholly different financial transactions and securities are involved there from those involved here. Respondent's counsel have adroitly prosecuted the two cases together and have taken full advantage of the similarity between the two complaints. As above stated the two cases were argued together before the Circuit Court of Appeals. This petitioner, as a defendant in the instant case only, has been severely prejudiced throughout by such similarity. It has obscured the essential weakness of the complaint in this case.

Indeed the Circuit Court of Appeals stated that the complaint in the instant case "is not as complete" as the Aiken complaint, but, without mentioning any of the allegations of the instant complaint, concluded that "in substance the complaints in the two cases make the same

allegations," and said that, "We are satisfied that the same result should be reached in this case as in Case No. 7430 [the *Aiken* case], especially as to the cause of action relating to the improper pledging of corporate assets."[1] (122 F. (2d) 755, 756) The Circuit Court of Appeals further stated: "That portion of the opinion rendered in Case No. 7430 which is applicable here, is incorporated by reference." (p. 757)

A.

Knowledge Is a Condition Precedent to Liability Under the Former Illinois Statute and Must Be Alleged as Well as Proven.

The cause of action relating to dividends arises solely under the former Illinois statute, Section 23 of the 1919 Illinois Corporation Act. That statute, as the Circuit Court of Appeals recognized, created liability only if the directors affirmatively and knowingly participated in the wrongful payment of dividends. The statute did not even purport to create liability for negligence or lack of financial wisdom. The Circuit Court of Appeals erred, however, in distinguishing between the pleadings and the evidence in respect to the indispensable requirement of knowledge.[2] The statute warrants no such distinction.

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[1] The Circuit Court affirmed the judgment of the District Court in favor of the defendants as to the improper pledging of assets, and the plaintiff has filed a petition for certiorari to review that ruling.

[2] The Circuit Court of Appeals in its opinion in the instant case stated: "We think that the pleadings in this case, as in No. 7430, sufficiently charge the defendants with participation. Perhaps the evidence will not show this. Perhaps the evidence will show, as to one or more of the defendants, a want of control or command, an attitude of gross negligence, an irregular attendance plus perfunctory exercise of the voting power, see *Lewis* v. *Montgomery*, 145 Ill. 30, 48, 33 N. E. 880, and *Slater* v. *Taylor*, 241 Ill. 102, 89 N. E. 271. Perhaps the evidence will not show this, but that is not important now." (122 F. (2d) 755, 757)

The cause of action in the instant case for alleged violation of the former Illinois dividend statute consists of the five sentences in the complaint quoted on pages 3-4 of the Petition. Section 23 provided that the directors should only be liable for declaring or assenting to a dividend if the corporation was, or was thereby rendered, insolvent, or its capital was impaired. The complaint makes no attempt to comply with this requirement of the statute but alleges in lieu thereof that the company had "no actual surplus" and that, if its books were changed to meet the plaintiff's partisan views as to proper "accounting practices", the company "did not in fact have cash income." Such allegations recognize that the company's books, upon which the petitioner, Stanley Field, was clearly entitled in good faith to rely, showed that it did, in fact, have a surplus.

Field's good faith is not even remotely questioned and the complaint does not allege that he had actual knowledge even of the asserted bookkeeping "irregularities", much less that the company was insolvent or its capital impaired. Since the complaint was fatally defective, the Illinois Constitution protects the defendants against the plaintiff's attempt seven years later to partially remedy the defects by filing an amendment. *Board of Education* v. *Blodgett*, 155 Ill. 441. Nor does even the amendment allege that this petitioner knew, when the dividends were declared and paid, or at any time, that the company was, or was thereby rendered, insolvent, or that its capital was thereby impaired. (R. 301-306) The amendment did not attempt to cure this fatal defect as to the petitioner because it could not be cured. In 1938 the Illinois Appellate Court after a careful scrutiny recognized the essential integrity of the conduct of the petitioner, Stanley Field. In *Howard* v. *Insull*, 294 Ill. App. 20 (being a companion proceeding instituted in the Illinois state court

against directors on behalf of creditors by the Bankruptcy Trustee of Corporation Securities Co. of Chicago) the Illinois reviewing court affirmed the Superior Court's dismissal of the complaint before trial as to Field.

The Supreme Court of Illinois in *Lewis* v. *Montgomery*, 145 Ill. 30, 46, cited by the Circuit Court of Appeals, has held that even if directors of a corporation were "grossly recreant to their legal duties as directors," they incur no liability under the former Illinois statute unless they affirmatively and knowingly participated in the wrongful payment of dividends. This rule, we submit, requires not only proof of knowledge but also direct allegations of such knowledge.

An earlier decision of the Circuit Court of Appeals for the Seventh Circuit in *White-Wilson-Drew Co.* v. *Lyon-Ratcliff Co.*, 268 F. 525 (1920) followed as controlling the rule laid down by the Supreme Court of Illinois in *Lewis* v. *Montgomery* as to liability under the former Illinois statute and affirmed the dismissal of a complaint which did not contain direct allegations of knowledge. In that case (as stated by the Circuit Court of Appeals) a complaint was filed by certain creditors under the Illinois statute to hold directors "liable for assenting to the payment of dividends by *Lyon-Ratcliff Company*, which it is alleged diminished its assets below the amount of the capital stock, and for assenting to the payment of dividends when the corporation was insolvent." (p. 526) It was not alleged in the complaint in the *Lyon-Ratcliff* case, however, that "the directors actually knew" the facts relating to the alleged impropriety. (p. 526) For this reason the District Court dismissed the complaint "for want of equity upon its face," holding "that such knowledge was a condition precedent to recovery." (pp. 526-527) The Seventh Circuit Court of Appeals stated that "the correctness of

that ruling presents the sole question here." (p. 527) After analyzing the holding of the Supreme Court of Illinois in *Lewis* v. *Montgomery*, the Circuit Court of Appeals concluded that: "We are of opinion that the words 'assenting thereto' mean a conscious approval of facts actually known", and affirmed the dismissal. (p. 527)

The settled construction of the former Illinois statute by the Illinois Supreme Court should have been followed by all federal courts. The rule of law was stated thus by this Court in *Burns Mortgage Co.* v. *Fried*, 292 U. S. 487, 493 (1934):

> "The applicable state statute furnishes the rule of decision for a federal court sitting in the state or outside its borders. And in that court the law must be given the meaning and effect attributed to it by the highest court of the state, as if the state court's decision were literally incorporated into the enactment, whatever the federal tribunal's opinion as to the correctness of the state court's views."[1]

Similarly, in *Minnesota* v. *Probate Court*, 309 U. S. 270 (1940), this Court, after discussing the Minnesota statute involved and the construction placed thereon by the Minnesota Supreme Court, stated at page 273:

> "This construction is binding upon us. Any contention that the construction is contrary to the terms of the Act is unavailing here. For the purpose of deciding the constitutional questions appellant raises we must take the statute as though it read precisely as the highest court of the State has interpreted it."

In the case of *White-Wilson-Drew Co.* v. *Lyon-Ratcliff*

[1] Equally binding upon federal courts is the state court's construction of a former state statute. In *Lisman* v. *Knickerbocker Trust Co.*, 211 Fed. 413 (C. C. A. 6, 1914), the court stated at page 420: "It is true that the statute of 1873 is not before us, but if it is clear that the construction placed upon that statute would logically and necessarily involve a similar construction of the statute of 1901, we should equally feel bound by the construction of the earlier statute adopted by the highest court of that state."

Co., cited above, the Circuit Court of Appeals for the Seventh Circuit recognized as controlling in all respects the construction placed on the Illinois statute by the Supreme Court of Illinois. It applied that construction to the pleadings as well as to the proof. The Court erroneously departed from that view in the instant case and refused to apply the test laid down by the Illinois court to the pleadings.

B.

The Word "Assent" in the Former Illinois Statute Meant Approval in Advance of Dividends and Not Ratification After Dividends.

The original complaint alleged that the defendant directors "authorized or ratified the payment of dividends" alleged to have been paid in violation of the Illinois statute. The amendment to the complaint proposed no substantial change in this respect as to the petitioner. The amendment stated that Field "assented to the declaration of the dividend described" (in the preceding paragraph) "by voting in favor of a resolution ratifying, confirming, or approving said dividend." (R. 302-303, pars. (f), (h), (j), (l), (n) and (p)) Moreover, the amendment affirmatively showed that Field was not present at any of the meetings of the directors of Corporation Securities Co. of Chicago, at which dividends were declared by the board of directors.

The original complaint in the instant case contained no reference to an executive committee. The amendment which plaintiff attempted to file alleged the formation of the executive committee consisting of certain members of the board of directors (not including Field) and showed that all of the dividends complained of were declared by directors who were members of the committee at meetings

not attended by Field. (R. 305, 306) The last paragraph of Section 23 provides that "*Unless a director was absent from the meeting at which such dividend was declared* • • • or unless his dissent therefrom shall be entered on the corporate records, he shall be conclusively presumed to have assented thereto." Necessarily the director who is absent from the meeting at which the dividend was declared is free from liability. While the statutory attempt to establish a conclusive presumption of fact against a director who was present at the meeting at which a dividend was declared renders the entire statute unconstitutional,[1] in our opinion, the quoted clause shows that the Illinois legislature did not intend that a director could be held liable who was not even present at the meeting. Concerning a similar statute in Oklahoma, the Supreme Court of that state said in *Watkinson* v. *Adams*, 103 Pac. (2d) 498, 500 (Okla., 1940):

> "The statute as conclusively excludes from liability the absent directors as it creates liability on the part of those who were present at the particular meeting and did not enter their dissent."

The principal opinion of the Seventh Circuit Court of Appeals, as stated, is in the *Aiken* case, to which Field has never been a party, but which nevertheless is incorporated by reference in the opinion in the instant case. In the *Aiken* opinion the Court states:

> "It is plain to us that the word 'assenting' includes the approval and ratification of a dividend after it has been declared." (122 F. (2d) 746, 753.)

This holding is entirely inconsistent with the construction of the Illinois statute by the Supreme Court of Illinois in *Lewis* v. *Montgomery*, 145 Ill. 30, 47, which is as follows:

> "In *Woolverton* v. *Taylor*, 132 Ill. 197, the statute sought to be invoked here was under consideration, and

[1] See *Carolene Products* v. *McLaughlin*, 365 Ill. 62, 70, 5 N. E. (2d) 447 (1936); *Chicago Motor Club* v. *Kinney*, 329 Ill. 120, 134, 160 N. E. 163 (1928).

> we there held, that while the liability imposed is not penal but contractual, it is like that of a surety and therefore *stricti juris*. This being the case, the statute should receive a construction in consonance with the nature of the obligation imposed. The words employed should be interpreted according to their plain and obvious meaning, and should not be extended by construction so as to embrace cases not clearly within the terms of the statute. The liability is created only where the indebtedness of the corporation exceeds the amount of the capital stock, and is imposed only upon the directors and officers assenting to such excess of indebtedness. This plainly means assenting to its creation. Manifestly, a recognition of the indebtedness by the directors after it has been so constructed as to become binding upon the corporation, should not have the effect of charging them with this statutory liability."

Subsequent Illinois cases have consistently held in conformity to the rule of the *Lewis* case that "assent" as used in the Illinois statute did not include "ratification." In *Slater* v. *Taylor,* 241 Ill. 102, 108, the Supreme Court of Illinois held:

> "It is true that the defendants would not be liable under the statute if they merely recognized the existence of the indebtedness after it was created * * *."

Similarly in *McCutcheon-Gerson Service* v. *The T. & R. Co.,* 236 Ill. App. 261, it was held that:

> "* * * the liability created by the statute exists only where the indebtedness of the corporation exceeds its capital and it is imposed only upon the directors and officers assenting to such excess of indebtedness and that this meant the assenting to the creation of the indebtedness and not merely recognizing it after it had been created."

In *Edwards* v. *Cleveland Dryer Co.,* 83 Ill. App. 643, 652, the Appellate Court for the First District, after discussing *Lewis* v. *Montgomery,* stated:

> "The court in the case cited not only held that section 16 should be strictly construed, but practically so con-

> strued it, by holding that persons who were directors when indebtedness in excess of the amount of the capital stock of the company was created, but who did not, in fact, participate in the creation of such excessive indebtedness, could not be made liable."

Similarly, the Appellate Court for the Fourth District in *Illinois State Bank* v. *Queen City Quarry Co.*, 203 Ill. App. 176, 177, held:

> "Mere recognition by a director or officer of a corporation of an indebtedness of the corporation in excess of its capital stock, or the fact he might have interposed to prevent such excess, is not sufficient to make him liable under Hurd's Rev. St. ch. 32, Sec. 16, providing that directors or officers of a corporation who assent to indebtedness in excess of its capital stock shall be personally and individually liable for such excess."

For the reasons stated above, this settled construction of the former Illinois statute should have been followed by the Circuit Court of Appeals.

CONCLUSION.

This petitioner respectfully urges that the Petition for a Writ of Certiorari filed by him herewith should be granted and that this Court on hearing should set aside the judgment of the Circuit Court of Appeals for the Seventh Circuit in so far as it reverses the order of the District Court, and affirm the decree of the District Court in all respects.

Respectfully submitted,

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